

ST 07-8

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

***JOHN DOE*, as responsible officer of *ABC*
Motors, Inc.,
Taxpayer**

No. 06-ST-0000

IBT: 0000-0000

NPL: 0000-000-00-0

**Mimi Brin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. George Foster, Special Assistant Attorney General, for the Illinois Department of Revenue

Synopsis:

This matter comes on for hearing pursuant to ***John Doe***'s (hereinafter referred to as "***Doe***" or the "Taxpayer") protest of Notice of Penalty Liability No. 0000-000-00-0 (hereinafter referred to as the "NPL") issued by the Department against ***Doe***, as a responsible officer or employee of ***ABC*** Motors, Inc. (hereinafter referred to as "***ABC***" or the "Corp"), for the periods of November 2003 through and including December 2003, January 2004 through May 2004, March 2005 and April, 2005 (hereinafter referred to as the "tax periods"). A hearing was held in this matter with ***Doe*** and other taxpayer witnesses providing testimony. ***Doe*** appeared *pro se*. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved, in

part, for the taxpayer and, in part, for the Department. In support thereof, the following findings of fact and conclusions of law are made:

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Notice of Penalty Liability No. 0000-000-00-0 showing a penalty for the tax liability of **ABC** Motors, Inc., of \$12,135.79, with interest calculated through May 5, 2006. Department Ex. No. 1
2. During the tax periods,¹ **Doe** was secretary of the corp. Taxpayer Ex. No. 4 (NUC-1 Illinois Business Registration); Transcript ("Tr.") p. 41 (**Doe**)
3. **Doe** was a 50% shareholder of the corp. Tr. pp. 40-41 (**Doe**)
4. **Mr. Smith** ("**Smith**") was the President of the corp. Taxpayer Ex. No. 4
5. **Smith** "accept[ed] personal responsibility for the filing of (Illinois taxes) returns and the payment of taxes due." Taxpayer Ex. No. 4
6. **ABC** sold used automobiles at retail. Taxpayer Ex. No. 4
7. The corp. began operation on October 1, 2003. Taxpayer Ex. No. 4
8. **Doe** spent almost all of his work-related time purchasing the used automobiles for the corp. to sell. Tr. pp. 13, 29 (testimony of **Mr. Jones**, corp. manager) ("**Jones**"); Tr. p. 35 (testimony of **Mr. Green**, salesman) ("**Green**")
9. **Smith** handled the day-to-day corp. activities, including, but not limited to, determining the final selling price of an auto, accepting the funds and paperwork for all autos sold by the corp. and signing and sending all of the

¹ Unless otherwise stated, findings of fact refer to the tax periods at issue.

necessary paperwork with remittances to the appropriate government offices. Tr. pp. 12-31 (*Jones*); Tr. pp. 34-36 (*Green*); Tr. pp. 37-38 (testimony of *Mr. Blue*, corp. porter/lot manager) (“*Blue*”);

10. *Doe* and *Smith* were signatories on the corp. checking account. Taxpayer Ex. No. 1 (corp. MidAmerica Bank statement for the month ending 2/28/04); 2 (corp. MidAmerica Bank statement for the month ending of 3/31/04); Department Ex. No. 3 (corp. check dated 1/9/04); 4 (corp. check dated 1/2/04); Tr. pp. 28-29 (*Jones*)
11. Rather than remitting the sales forms and funds for completed sales to the necessary government agencies, *Smith* was secretly placing completed sales documents into the ceiling in his office, thereby removing them from discovery by any personnel. Tr. pp. 17-18 (*Jones*); Tr. pp. 55-56 (*Doe*)
12. This action of concealing sales documents that were evidence of the corp.’s failure to remit pertinent taxes to the State of Illinois was discovered in May, 2004, when the ceiling fell in and all of the paperwork was found soaked with water on the floor of *Smith*’s office. Department Ex. No. 2 (Complaint At Law #04L011899, Circuit Court of Cook County); Tr. p. 49 (*Doe*)
13. On those occasions, when *Doe* and *Smith* met on the corp. premises prior to May, 2004 to discuss business, completed sales folders were clear of delinquent paperwork indicating that there were no forms or payments that were not current for filing or payment. Tr. pp. 53-54 (*Doe*)

14. **Doe** filed a lawsuit against **Smith** in the Circuit Court of Cook County, Illinois, wherein **Doe** alleged, *inter alia*, that **Smith** had converted, for his own use, monies paid to the corp. for automobiles purchased. The lawsuit states that it was in May, 2004 that **Doe** became aware that **Smith** was defrauding the corp. In May, 2005, judgment was entered for **Doe** and against **Smith** in this lawsuit. Department Ex. No. 2

Conclusions of Law:

The Illinois Uniform Penalty and Interest Act, 35 ILCS 735/3-1 *et seq.*, provides, in pertinent part, as follows:

§3-7. Personal Liability Penalty.

- (a) Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including penalties and interest thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of that determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue.

35 ILCS 735/3-7

Pursuant to this statute, an officer or employee of an entity such as **ABC Motors, Inc.** can be held personally liable to the State for pertinent unpaid taxes if he had the control, supervision or responsibility of filing tax returns and making the payments reflected thereon (hereinafter referred to as the "responsibility") and willfully failed to

file such returns or make such payments. *Doe* argues that there was a definite division of corporate responsibilities between himself and *Smith*. His duties were to purchase the used cars sold by *ABC* and to have them delivered to its car lot. He further states that *Smith* was the person who was to operate the day-to-day activities of the corp., including completing and filing all documentation for car sales and for paying all of the taxes collected and owed. He concludes that based upon these facts he is not liable for the taxes represented in the NPL.

The NPL issued herein against *Doe* establishes the Department's *prima facie* case that he was a corporate officer who had the responsibility for filing the pertinent tax returns and who willfully failed to pay taxes due from the corp. Branson v. Department of Revenue, 168 Ill. 2d 247, 260 (1995) ("by operation of the statute, proof of the correctness of such penalty, including the willfulness element, is established by the Department's penalty assessment and certified record relating thereto"). The burden then shifts to the taxpayer to overcome the presumption of liability through sufficient evidence that the person was either not a responsible officer or employee or that his actions were not willful. Id.

The Illinois Supreme Court, in cases wherein it considered personal liability based upon corporate tax liability, has referred to interpretations of similar language in section 6672 of the Internal Revenue Code (26 U.S.C. §6672), which imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes. Branson v. Department of Revenue, *supra*; Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19 (1985); Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568 (1977.).

Generally, Federal courts have considered specific facts in determining whether individuals were liable for the payment of employee taxes, to wit: 1) the duties of the officer as outlined by corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors, and shareholders of the corporation; 4) the identity of the individuals who hired and fired employees; and, 5) the identity of the individuals who were in control of the financial affairs of the corporation. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), cert. den. 400 U.S. 821 (1970); Gephart v. United States, 818 F.2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990).

Regarding the issue of whether an individual was a responsible person pursuant to statute, such persons may include officers who can borrow money on behalf of the corporation (Peterson v. United States, supra), and may be those with check writing authority who may or may not be the ones with the responsibility for accounting, bookkeeping or the making of payments to creditor. Monday v. United States, supra; Wright v. United States, 809 F.2d 425 (7th Cir. 1987); Calderone v. United States, 799 F.2d 254 (6th Cir. 1986). There may be more than one responsible person in a corporation. Monday v. United States, supra; Williams v. United States, 931 F.2d 805, 810 n.7 (11th Cir. 1991).

In the instant matter, ***Doe*** owned 50% of the stock in the corp. He was actively employed by the corp. during this time and was taking a salary. Tr. pp. 43-44 (***Doe***). He had check writing authority and, in fact, signed checks during the tax periods. He admits that he met with ***Smith*** during this time to discuss corp. finances and he also admits that he had access to ***Smith***'s office and files. He avers, however, that he had no knowledge

that taxes were not being paid and that documents were not being completed and forwarded to the proper governmental agencies because, up until May 2004, whenever he went to *Smith*'s office to look at the files regarding sales, the folders did not contain any documents that showed *ABC* was delinquent in any filings or payments. This indicated to *Doe* that there were no filings or payments outstanding. However, legal responsibility for the payment of taxes to the State is a matter of status, duty and authority, not necessarily knowledge. Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979). I find, therefore, that *Doe* was a responsible officer during the entire tax period.

As to the willful element, although the pertinent statute fails to define willful conduct, Illinois courts have provided guidance for its determination. Willfulness "does not require a showing of actual knowledge of nonpayment [of taxes]". Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366, 375 (1st Dist. 2000). Rather the Illinois Supreme Court accepts as indicia of willfulness a showing of "reckless disregard for obvious or known risks" as set forth in cases dealing with section 6672 of the Internal Revenue Code. Branson v. Department of Revenue *supra* at 255; Department of Revenue v. Heartland Investments, *supra*; Monday v. United States, *supra*. In the case of Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987), the Seventh Circuit Court of Appeals stated that:

But bearing in mind that if a high degree of recklessness were required the purpose of the statute would be thwarted, just by compartmentalizing responsibilities within a business (however small) and adopting a "hear no evil-see no evil" policy, we think gross negligence is enough to establish reckless disregard. Concretely we hold that the 'responsible person' is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily.

This statement is reflective of court determinations which consistently find that willfulness may be established with a showing that the “responsible party clearly ought to have known of a ‘grave risk of nonpayment’ and who is in a position to easily find out, but does nothing.” Branson v. Department of Revenue, supra at 255 (citing Ruth v. United States, 823 F.2d 1091 (7th Cir. 1987)) Further, it is without contest that “[w]illfulness is present if the responsible person had knowledge of the tax delinquency and knowingly failed to rectify it when there were available funds to pay the government.” Gephart v. United States, supra at 475.

Based upon the facts of record, I cannot conclude that **Doe** willfully failed to pay the State all of the taxes represented in the NPL. His testimony, that until May 2004, **Smith** actively kept documentation reflecting corp. sales and delinquent tax payments hidden, is confirmed by the competent and credible testimony, at hearing, of another witness. **Smith**’s deceit was uncovered only because his concealment of sales documents was revealed when the ceiling in his office collapsed and the water soaked documents were discovered by corp. personnel.

The corp. began selling at retail in October 2003. It had, therefore, been in business for about seven months when **Smith**’s deceit was uncovered. Until that time, there is nothing in the record that would cause a conclusion that **Doe** knew or should have known that documents were not being filed with the State and that taxes were not being paid. Thus, I cannot conclude that from October 2003 until May 2004, **Doe** willfully failed to pay the taxes owed by the corp. as required by statute. The

same, however, cannot be said for the tax periods from May 2004. At that time **Doe** did know that there was a definite problem with the filing and payment of State taxes. It is

also from that time that, as a responsible corp. officer, he was in a position to see that taxes were paid.

As a result, I conclude that *Doe* was an officer of *ABC* who was, statutorily, responsible for the filing and payment of taxes during the entire tax period. I find, however, that he willfully failed to pay those taxes from May 2004 forward only. See, McLean v. Department of Revenue, 326 Ill. App. 3d 667 (1st Dist. 2001).

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Penalty Liability at issue herein be finalized against *John Doe* for only the months of May 2004 forward.

Date: 4/6/2007

Mimi Brin
Administrative Law Judge